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INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE

C O N F I D E N T I A L SECTION 01 OF 03 BUDAPEST 000270

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E.O. 12958: DECL: 03/11/2018

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SUBJECT: SQUATTER'S RIGHTS: THE GYURCSANY GOVERNMENT AFTER
THE REFERENDUM

REF: A) BUDAPEST 261 B) BUDAPEST 225

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (C) Summary: The Gyurcsany government is struggling to go on with business as usual in the aftermath of its losses in the March 9 referendum. Unfortunately, business as usual involves an opposition with the political momentum, party members with a personal grudge, and policy initiatives without popular support. MSzP insiders describe a "state of shock" within the party, but the various scenarios for a leadership change in the near term will apparently have to contend with Gyurcsany's resolve to stay on. Although maneuvering will continue behind the scenes as the MSzP's Party Conference approaches March 29, any replacement would still confront economic uncertainty, popular antipathy, and - with the precedent set by the referendum - a system that may be moving from unenviable to ungovernable. End Summary.

"---- OFF, FERI!"

¶2. (C) With the shock waves of the March 9 referendum still reverberating throughout the government (REF A), Prime Minister Gyurcsany is struggling to keep his grip on the reins. As Hungary's National Day approaches on March 15, the search for a positive spin on the results has thus far escaped the government. Indeed, his own coalition partner's spokesperson was captured on film summing up the results of the referendum as a public call to "---- off, Feri!"

¶3. (C) The opposition has been restrained in its response thus far. Press accounts suggest that FIDESZ does not want to alienate the estimated 800,000 undecided and MSzP voters who sided with them in the referendum, and claim that the party has decided to down-play distinctions between right and left in order to focus on a message of national unity. MSzP MP Vilmos Szabo notes that "Orban is playing this very wisely," noting that he will win even more public support "if there are no problems on March 15."

¶4. (C) At a March 12 briefing for the diplomatic corps, FIDESZ President Viktor Orban emphasized the government's responsibility to "draw the consequences from the referendum and to respond to the will of the people." Although he charged that the current government has "neither the force to carry out its own proposals nor any visible policy to suggest it has any understanding of reform," he concluded that "only the majority can change the government."

INTERVENTION BY THE MSZP?

¶5. (C) And the MSzP itself may yet be Gyurcsany's undoing: emboldened by the overwhelming rejection of key elements of "the Gyurcsany Package" and tired of what Szabo describes as a "ridiculously" restricted decision-making process, rivals within the party) including many within the cabinet - are

reportedly considering a change at the top.

¶ 6. (C) The scenarios vary. We've heard estimates that Gyurcsany will leave before the MSzP Party Conference on March 29 (which technically cannot make personnel decisions but will give the party leadership the opportunity to meet behind closed doors), but also projections that the party will take time to "digest" the referendum and consider a change closer to the 2009 European Parliamentary elections. FIDESZ faction leader Tibor Navracsics fully expects the MSzP to make a change in the near term, and even admits that they "still have time" to distance themselves from Gyurcsany's policies and rally before the 2010 national elections.

¶ 7. (C) But the lack of a clear successor continues to bedevil the party. Most observers see either Cabinet Minister Peter Kiss or Defense Minister Imre Szekeres) both traditional party stalwarts - as the likely successors. Finance Minister Veres' name is in circulation (though pending corruption charges against his son may be too much of a liability), and Szabo believes National Bank President Simor might also emerge as a compromise choice. Ivan Botka, the young mayor of Szeged, is mentioned as a long shot, but the prevailing sense is that the party will look for what one diplomat described as "a safe pair of hands."

SURROUNDED BUT NOT SURRENDERING?

¶ 8. (C) There is also another problem: Gyurcsany reportedly doesn't want to step down. Szabo believes that the PM will be inclined to ride out the current "chaos" in the party, commenting ruefully that Gyurcsany is unlikely to "start listening to the party now."

¶ 9. (C) Meanwhile, however, Gyurcsany's supporters have

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little ammunition to defend the PM. The referendum will badly undermine his usual argument that only he can beat Orban in an election. The economic forecasts are, to quote one analyst, "torn between dark (and darker)." After more than a year of promising better communication from the Prime Ministry to win public support for reforms (and sounding rosy sums on staffing), the common rationalizations of "we always knew we would lose the referendum" and "three million voted against us but four million didn't vote at all" are hardly inspiring battle cries.

¶ 10. (C) Nor has the government regained its balance this week. After a public exchange with the President of the Constitutional Court over the referendum and a seeming refusal to even discuss funding alternatives for education and health care, the government seems reactive and ruthless. As one diplomat suggested, "the government can only distract attention from one mistake by making another."

ROAD CLOSED

¶ 11. (C) There are few roads open to the PM as he tries to steer past the wreckage of the referendum. His policy initiatives are simply not enough to overcome his political problems: his "Public Ownership Initiative" to privatize state holdings has already been undercut by criticism from the economic community, tax reform is still a subject of debate even within the coalition, and the details of the recent South Stream deal will remain subject to political questions and potentially legal challenge from the opposition (REF B). Tired of "an hour's advance notice" on major policy initiatives, MSzP MPs are publicly deriding the PM's "so-called Socialism," and some in the party believe the best case scenario is limiting the damage to a "credible defeat" in the next elections. Szabo fears that FIDESZ could win a two-thirds majority, thus enabling them to make "permanent changes."

WILL CHANGING FACES CHANGE THE FACTS?

¶12. (C) These factors make a move against the Prime Minister more likely. We must bear in mind, however, that changing Gyurcsany might change the mood but it will not change the facts:

Anemic growth, declining FDI, and instability in the bond market have combined with record unemployment, continued concerns re transparency, and minimal insulation from broader international financial trends. With so many variables in the equation, a hamstrung Gyurcsany government will be hard pressed to address them all. Moreover, any new Prime Minister will face a difficult balancing act between EU obligations to reduce the deficit and the political temptation to raise spending before the elections of 2009-10.

Foreign policy will still matter little to the average Hungarian, giving a government eager to garner public favor little incentive to make hard choices) much less hard sacrifices) on many of our key policy priorities.

Although public ire united many Hungarians against "the Gyurcsany package," even Orban admits that the referendum reflects broad mistrust of the entire political class. Opposition could quickly transfer to the new Prime Minister, making for a very brief honeymoon.

Moreover, "letting the MSzP be the MSzP" is not likely to accelerate reforms. Quite to the contrary: any replacement) particularly a party insider - will likely want as much distance as possible from Gyurcsany's stylistic approach as well as his substantive direction. That likely portends a return to the party's core platform of "solidarity," and with it a return to higher spending in pursuit of political popularity rather than financial responsibility.

Finally, the referendum itself may complicate matters considerably. Having established a precedent that makes virtually all government policies subject to revision by referendum, Hungarians may have sacrificed governability for democracy. As commentQr Krisztian Szabados hQcommented, foreign investors will now hQ to consider Hungary a less predictable) and less attractive - environment.

DYING ON BORROWED TIME

¶13. (C) Comment: Gyurcsany may be moving from a surprising electoral victory in 2006 to an almost-universally predicted departure before the next elections. For many in the MSzP, Gyurcsany is new Coke: a costly failed experiment with a

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bitter aftertaste. Half-way through his term, the MSzP sees his policies winning few converts while alienating many traditional supporters. Many in the party feel that they are becoming the victims of Gyurcsany's self-inflicted wounds, and that a move against him will be better than another) and potentially irreversible) move down in the polls. If the Prime Minister chooses not to exit gracefully, they will confront a choice between looking divided with a vote of no confidence (or remaining divided with Gyurcsany in office. End Comment.

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